


M e m o r a n d u m

To: Honorable Betty T. Yee, Chairwoman
Honorable Judy Chu, Vice-Chair
Honorable Bill Leonard, Second District
Honorable Michelle Steel, Third District
Honorable John Chiang, Controller

Date: April 13, 2007

From: Kristine Cazadd
Chief Counsel 

Subject: **Petition for Amendment of Property Tax Rule 462.060**
Change in Ownership – Life Estates and Estates for Years
April 25, 2007 Board Meeting – Chief Counsel Matters – Item J – Rulemaking

By a letter received on March 8, 2007, Mr. Stephen Bennett petitioned the Board, pursuant to Government Code section 11340.6, to amend Property Tax Rule¹ 462.060, *Change in Ownership - Life Estates and Estates for Years*, to add a new change in ownership exclusion for the creation of life estates based on a value equivalency test that considers both the age and actuarial life expectancy of the new life tenant. This matter is scheduled for the Board's consideration at the April 25, 2007 meeting² on the Chief Counsel Matters Agenda. On April 25, the Board may: (1) deny the petition; (2) grant the petition in part or in whole and commence the official rulemaking process by ordering publication of the notice pursuant to Government Code section 11346.5; or (3) direct staff to commence an interested parties process to consider the requested amendment in part or in whole. Staff recommends that the petition be denied because Rule 462.060, subdivision (a) is consistent with Revenue and Taxation Code sections 60 and 62, subdivision (e) as well as recent appellate court decisions.

This memorandum will set forth: (1) a general background of change in ownership law regarding life estates; (2) a discussion of the petition and the requested amendment; and (3) a discussion of the staff's recommendation to deny the petition.

I. General Background of Rule 462.060, Subdivision (a)

Revenue and Taxation Code section 60 defines "change in ownership" as single test with three elements: "a transfer of a present interest in real property, including the beneficial use thereof, the value of which is substantially equal to the value of the fee interest." The third element, known as the "value equivalence" element, ensures that only transfers of property interests that represent the primary value of the real property are considered changes in ownership. Revenue

¹ All "Property Tax Rule" or "Rule" references are to title 18 of the California Code of Regulations.

² Under Government Code section 11340.7, the Board has 30 days from receipt to deny the petition in whole or in part, indicating the reasons why, or to initiate the rulemaking process. Mr. Bennett waived the 30-day deadline.

and Taxation Code section 61 et seq. provides examples of transfers that result in changes in ownership and examples of transfers that do not. As relevant herein, section 62, subdivision (e), excludes from change in ownership:

[a]ny transfer by an instrument whose terms reserve to the transferor an estate for years or an estate for life. However, the termination of such an estate for years or estate for life shall constitute a change in ownership, except as provided in subdivision (d) [transfers involving trusts] and in Section 63 [interspousal exclusion].” [Parentheticals added.]

In establishing this exclusion, the Legislature placed no qualifications as to the nature or length of the life estate.

To interpret sections 60 and 62, subdivision (e), the Board concurrently promulgated Property Tax Rule 462 (the predecessor to Rule 462.060) which provided that:

(1) The following transfers do not constitute a change in ownership:

* * *

(3) Any transfer by an instrument whose terms reserve to transferor, the transferor’s spouse or both of them an estate for years or an estate for life. When such reserved estates both terminate and if the provisions of this section relating to trusts and interspousal transfers do not provide otherwise, a change in ownership shall be deemed to have occurred.

Subdivision (1) of former Rule 462 was adopted on August 16, 1979, and became effective on August 22, 1979, contemporaneously with the adoption of sections 60 and 62, which were added by statutes 1979, chapter 242, effective July 10, 1979. Current Rule 462.060, subdivision (a), retains the substance of former Rule 462, subdivision (1), as follows:

The creation of a life estate in real property is a change in ownership at the time of the transfer unless the instrument creating the life estate reserves such estate in the transferor or the transferor’s spouse. However, the subsequent transfer of such a life estate by the transferor or the transferor’s spouse to a third party is a change in ownership. Upon termination of such a reserved life estate, the vesting of a right to possession or enjoyment of a remainderman (other than the transferor or the transferor’s spouse) is a change in ownership.

Thus, as stated above, Rule 462.060, subdivision (a) applies the plain language of section 62, subdivision (e), that the creation of a life estate is a change in ownership unless that life estate is retained by the transferor or the transferor’s spouse.³

³ Under current law, in which section 60’s definition of “change in ownership” has been modified by initiative and further clarified by the Legislature, the creation of a life estate may also be excluded from a change in ownership if any statutory exclusion applies, e.g., the parent-child or grandparent-grandchild exclusion.

A. Report of the Task Force on Property Tax Administration

The interpretation of Revenue and Taxation Code section 60, subdivision (e) as set forth in Rule 462.060, subdivision (a) is consistent with the recommendations of the “Report of the Task Force on Property Tax Administration” (Task Force Report), submitted to the Assembly Committee on Revenue and Taxation on January 22, 1979. In interpreting the change in ownership provisions of Revenue and Taxation Code section 60 et seq., courts have long relied on the explanations and rationales set forth in Task Force Report. (See *Pacific Southwest Realty v. County of Los Angeles* (1991) 1 Cal.4th 155, at 161-162.) The following is the Task Force Report discussion of the value equivalence element of the “change in ownership” test ultimately enacted as section 60:

Value Equivalence. The ‘value equivalence’ test is necessary to determine who is the primary owner of the property at any given time. Often two or more people have interest in a single parcel of real property. . . . [I]n determining whether a change in ownership has occurred it is necessary to identify but one primary owner . . . so that only a transfer by him will be a change in ownership and when it occurs the whole property will be reappraised.

(Task Force Report, pp. 39-40 (emphasis in original).)

Accordingly, when two or more persons have an interest in a single parcel of real property, it is necessary to identify the one “primary owner” of the real property. In the case of life estates, the Task Force recommended, and the Legislature decided, that the life tenant is that primary owner and that the creation of a life estate is a change in ownership unless reserved for the transferor or the transferor’s spouse. (Task Force Report, p. 44; Rev. & Tax. Code, §§ 60 and 62 subd. (e).)

B. Appellate Court Decisions - Creation of a Life Estate is a Change in Ownership

Two published Court of Appeal decisions have applied Rule 462.060, subdivision (a) to conclude that the creation of a life estate is a change in ownership: (1) *Leckie v. County of Orange* (1998) 65 Cal.App.4th 334; and (2) *Reilly v. City and County of San Francisco* (2006) 142 Cal.App.4th 480. In *Leckie*, the Court of Appeals held that the creation of a life estate for the benefit of a 58-year old nonspousal third party is a change in ownership. The *Leckie* court determined that the creation of a life estate met the value equivalence test under section 60. To reach that conclusion, the court interpreted the plain language of subdivision (e) of section 62 to conclude that the creation of a life estate, other than those reserved for the transferor or the transferor’s spouse, is a change in ownership, upholding Rule 462.060, subdivision (a). (*Leckie, supra*, at p. 339.)

The Court of Appeal reached the same conclusion in *Reilly v. City and County of San Francisco, supra*. In *Reilly*, the court analyzed the change in ownership consequences of property held in trust where the trustor created successive lifetime beneficiaries who each received an interest in the net income of certain California real property. (*Reilly v. City and County of San Francisco* (2006) 142 Cal.App.4th 480.) The Court of Appeal concluded that a change in the trust’s lifetime beneficiary constituted a change in ownership of all the real property held by the trust. In reaching that conclusion, the *Reilly* court applied subdivision (a) of Rule 462.060 to find that

“a life estate in real property is an interest equivalent in value to the fee interest.” (*Reilly, supra*, at pp. 495-96.) Thus, consistent with *Leckie*, the appellate court concluded that a change in the lifetime beneficiary of real property is a change in ownership of that property, unless that interest is reserved for the transferor or the transferor’s spouse.

II. Discussion of Petition

The petition requests that the Board amend subdivision (a) of Rule 462.060 to add the following underlined text:

The creation of a life estate in real property is a change in ownership at the time of transfer unless a) after considering the age and life expectancy of the life tenant at the time of transfer it is determined the value of the transferred life estate is not substantially equal to the value of the fee interest, or b) the instrument creating the life estate reserves such estate in the transferor or the transferor’s spouse.

Mr. Bennett states in his petition that subdivision (a) of Rule 462.060 should be amended as indicated above because the creation of a life estate may not meet the three-part change in ownership test established by section 60 of the Revenue and Taxation Code. Specifically, Mr. Bennett contends that the creation of certain life estates does not transfer an interest in real property substantially equivalent to the value of the fee interest. Thus, Mr. Bennett proposes to establish a new change in ownership exclusion for the creation of a life estate based upon a value test that considers both the age and actuarial life expectancy of the new life tenant.

To illustrate, Adam (A) dies leaving a life estate in real property to Barbara (B), an individual unrelated to A, and a remainder interest to Carole (C), A’s only child. B is 75 years old on the date of A’s death and has a remaining life expectancy of 10 years. Under current law, the creation of B’s life estate constitutes a change in ownership unless B otherwise qualifies for an exclusion (for purposes of this illustration, we assume that B does not qualify for any other exclusion). This change in ownership results without giving any consideration to the transferee’s age or life expectancy.

If the Board grants this petition, then, given the facts set forth in the above illustration, the county assessor would be required to determine whether the value of B’s life estate on the date of A’s death is substantially equal to the value of the fee interest in the real property. Under the proposed amendment, no change in ownership would occur if the county assessor determines that the estimated present value of B’s life estate is “not substantially equal to the value of the fee interest.” The county assessors would be required to make such a case-by-case analysis upon the creation of every life estate in California real property.

Additionally, although the petition proposes to refer to California probate law and Federal estate tax law to provide county assessors with a method for estimating the value of each life estate created, the petition does not provide specific details as to any particular appraisal methodology. Thus, it appears that county assessors may have administrative difficulties if the petition is granted.

III. Staff's Recommendation

Staff recommends that the Board deny the petition because Rule 462.060, subdivision (a) conforms both to the applicable statutes and recent published appellate court decisions. In staff's opinion, the change in ownership treatment of life estates is well-settled law. As discussed above, the Board's rule correctly interprets the plain language of sections 60 and 62, subdivision (e), and is consistent with the legislative intent indicated by the Task Force Report in determining that the life tenant is the primary owner under section 60. Thus, it is staff's opinion that Revenue and Taxation Code sections 60 and 62, subdivision (e) clearly contemplate the change in ownership treatment of life estates reflected in the Board's existing rule.


Furthermore, it is staff's opinion that, absent legislative change or an appellate court holding otherwise, the proposed amendment to Rule 462.060, subdivision (a) to exclude the creation of certain life estates from change in ownership is beyond that the scope of the exclusion authorized by the Legislature in subdivision (e) of section 62, which only excludes the creation of life estates reserved for the transferor or the transferor's spouse. Therefore, staff recommends that the petition be denied.

IV. CONCLUSION

To summarize, staff recommends that the Board deny the petition to amend Rule 462.060, subdivision (a) which proposes to create a new change in ownership exclusion for the creation of a life estate based upon a value test that considers both the age and actuarial life expectancy of the new life tenant. It is staff's opinion that Rule 462.060, subdivision (a) conforms to the applicable statutory provisions and published appellate court decisions. Lastly, it is staff's opinion that the requested amendment would require new legislation.

If you need more information or have any questions, please contact Acting Assistant Chief Counsel Robert Lambert at (916) 324-6593.

Approved: _____


Ramon J. Hirsig
Executive Director

KEC:SC:jh

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